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ARA - MR. KUBISCH

EB - MR. ENDERS (SUBSTANCE)

S/S:SEFRY

ARA/CAR - MR. BURKE (SUBSTANCE)

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TAGS: EFIN, EMIN, US, JM

SUBJECT: JAMAICAN BAUXITE NEGOTIATIONS

REF: ALEXANDRIA 78 (SECTO 145)

1. PARA. 4 REFTEL ASKS WHAT ARE THE ALTERNATIVES IF NEGOTIATIONS BREAK DOWN AND LEGISLATIVE COURSE IS INITIATED BY GOJ. THIS CABLE OUTLINES OUR PRESENT ANALYSIS OF HOW THE SITUATION MAY DEVELOP, ITS IMPLICATIONS FOR UNITED STATES INTERESTS, AND THE BASIC OPTIONS THAT MAY BE OPEN TO THE USG. WE ARE PREPARING A MORE COMPREHENSIVE ANALYSIS FOR YOUR CONSIDERATION IN LIGHT OF THE SITUATION AS IT DEVELOPS.

2. IT SEEMS FAIRLY CLEAR THAT IF AGREEMENT IS NOT REACHED BY MAY 14 THE GOJ WILL TAKE SOME LEGISLATIVE INITIATIVE ON MAY 16. THE OUTLOOK FOR THE NEGOTIATIONS IS NOT GOOD.

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THE GOJ HAS A NUMBER OF OPTIONS, INCLUDING (A) ANNOUNCEMENT

OF BAUXITE REVENUE FIGURE IN CONTEXT BUDGET PRESENTATION WITHOUT TABLING LEGISLATION ON BAUXITE TAXES AS SUCH; (B) TABLING LEGISLATION AUTHORIZING GOVERNMENT TO ESTABLISH NEW BAUXITE TAXES BY AGREEMENT OR BY MINISTERIAL ACTION; (C) TABLING LEGISLATION ABROGATING BAUXITE AGREEMENTS AND UNILATERALLY ESTABLISHING INCREASED TAXES

AND ROYALTIES AT STATED LEVELS. THE JAMAICANS HAVE INDICATED SUCH LEGISLATION WOULD BE BASED ON 7.5 PCT OF INGOT PRICES (YIELDING APPROXIMATELY \$170 MILLION IN REVENUE OR ABOUT SEVEN TIMES PRESENT PAYMENTS) BUT THEY MIGHT BE PERSUADED TO SET A LOWER FIGURE. THE GOJ COULD OFFER TO REVIEW WHATEVER IS LEGISLATED WITHIN A YEAR OR SO TO SEE IF THE AMOUNT IS CONSISTENT WITH THE COMPANIES' ABILITY TO PAY BASED ON ALUMINUM DEMAND, WHICH THE GOJ EXPECTS TO REMAIN STRONG. ONCE THE GOJ TABLES A BILL IT HAS FURTHER OPTIONS CONCERNING HOW FAST IT PRESSES FOR ENACTMENT. WE EXPECT THE GOJ WOULD PAUSE TO SEE IF IT MIGHT STILL BE POSSIBLE TO REACH ITS OBJECTIVES WITHOUT CONFRONTATION WITH THE USG.

3. THE COMPANIES CAN REACT IN A VARIETY OF WAYS. CUTLER HAS INDICATED THOSE FIRMS WITH ICSID (WORLD BANK CENTER FOR DISPUTE SETTLEMENT) CLAUSES (I.E., REYNOLDS, ALCOA AND KAISER ON ITS BAUXITE OPERATIONS; ALPART AND REVERE DO NOT) WOULD INITIATE ICSID PROCEEDINGS. THEY RECOGNIZE SUCH ACTION WOULD INFLAME THE SITUATION FURTHER BUT BELIEVE IT MAY BE NECESSARY TO PRESERVE THEIR LEGAL CLAIM FOR DAMAGES. ONCE THE GOJ ACTUALLY MOVES TO COLLECT INCREASED PAYMENTS, THE COMPANIES, FAILING AGREEMENT WITH THE GOJ ON A MODUS VIVENDI, CAN EITHER PAY UNDER PROTEST, MOVE TO SHUT DOWN OPERATIONS, OR REFUSE TO PAY AND AWAIT THE GOJ REACTION. OUR BEST GUESS IS THAT THE COMPANIES WOULD PAY, PROTEST AND PERHAPS GO TO ICSID. SOME OF THEM MIGHT BEGIN TO CURTAIL OPERATIONS AND DISINVEST FROM JAMAICA AND ALL WOULD BE LOOKING HARD FOR ALTERNATIVE SOURCES OF SUPPLY. WE DO NOT BELIEVE THE COMPANIES CAN AFFORD TO SHUT DOWN THEIR OPERATIONS IN JAMAICA AND DO NOT RULE OUT THE POSSIBILITY THAT THEY MIGHT GRUDINGLY ACQUIESCE IN THE JAMAICAN ACTION WITHOUT

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RISKING SUCH PROTESTS AS WOULD JEOPARDIZE THEIR OPERATIONS. IN THE SHORT TERM (2 TO 5 YEARS) THE COMPANIES' ARE HEAVILY DEPENDENT ON JAMAICAN SOURCES OF SUPPLY. (U.S. COMPANIES GET 40 PCT OF THEIR RAW MATERIALS FROM JAMAICA.) OVER A LONGER TERM THERE COULD BE SUBSTANTIAL ALTERNATIVE SOURCES OF BAUXITE (MAINLY GUINEA AND AUSTRALIA) AS WELL AS OTHER HIGHER COST, DOMESTIC CLAYS. HOWEVER, IT IS DIFFICULT TO FORECAST WHETHER JAMAICAN BAUXITE WILL

BECOME NON-COMPETITIVE AS THE COMPANIES NOW MAINTAIN.
A MAJOR FACTOR IN THE COMPANIES' CALCULATION WILL BE OPIC
INSURANCE WHICH COVERS APPROXIMATELY \$500 MILLION OF THEIR
\$850 MILLION INVESTMENT IN JAMAICA. HOWEVER OPIC HAS
SOME LEVERAGE WITH THE COMPANIES UNDER ITS INSURANCE
CONTRACTS.

4. THE IMPLICATIONS OF ANY OF THESE SCENARIOS FOR UNITED
STATES INTERESTS ARE SERIOUS. FOR EXAMPLE, THE COSTS OF
MEETING THE JAMAICAN DEMANDS, IF PASSED ON TO THE CONSUMER,
COULD CAUSE AN INCREASE IN THE PRICE OF PRIMARY METAL OF,
PERHAPS, THREE CENTS A POUND. HOWEVER, UNLESS WORLD
PRICES RISE TO MATCH JAMAICAN INCREASES THE COMPANIES WILL
NOT BE ABLE TO PASS ON THE FULL COST. MOREOVER, ALUMINUM
PRICES HAVE RISEN FROM 25 TO 31.5 CENTS SINCE REMOVAL OF
PRICE CONTROLS AND ARE ALREADY FORECAST TO RISE ANOTHER
SEVERAL CENTS BY THE END OF THE SUMMER. THUS, THE
JAMAICANS MAINTAIN THAT THE PRICE OF METAL WILL BE DETER-
MINED BY A CONTINUING SHORT SUPPLY SITUATION AND THAT
THEIR DEMANDS WILL HAVE IMPACT ON U.S. CONSUMERS.

5. A SECOND CONCERN IS WHETHER THE JAMAICAN DEMANDS WILL
SO DAMAGE THE COMPANIES' PROFITABILITY AS TO JEOPARDIZE
FUTURE INVESTMENT IN THE INDUSTRY. THE SIX COMPANIES'
PROFITS INCREASED FROM \$220 MILLION IN 1972 TO \$373
MILLION IN 1973 AND ARE EXPECTED TO INCREASE SUBSTANTIALLY
IN 1974. THE JAMAICANS ARE CONVINCED THAT INCREASING
PRICES MEANS SOARING COMPANY PROFITS AND THEY WANT A
LARGER SHARE. THE COMPANIES CAN DEMONSTRATE, HOWEVER,
THAT HISTORICALLY THERE IS NO REAL CORRELATION BETWEEN
PRICE AND PROFIT LEVELS AND IT IS UNSOUND TO ASSUME THAT,
AFTER YEARS OF RELATIVELY LOW PROFITS, THE INDUSTRY'S
RATE OF RETURN WILL SUDDENLY AND PERMANENTLY DOUBLE. THE
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MAIN UNCERTAINTIES ARE COSTS OF PRODUCTION, SUCH AS
ENERGY AND OTHER IMPORTS, WHICH ARE RAPIDLY INCREASING
AND DEMAND PREDICTIONS WHICH VARY CONSIDERABLY.

6. THE UNITED STATES ALSO HAS TO BE CONCERNED ABOUT THE
RADIATION EFFECTS OF THE JAMAICAN ACTION BOTH WITH
RESPECT TO PRICES OF OTHER PRIMARY PRODUCTS AND WITH
REGARD TO THE INTEGRITY OF INVESTMENT AGREEMENTS. THE
PATTERN HAS BEEN SET BY OPEC AND BAUXITE IS SEEN BY SOME
AS A TEST CASE. WE ALSO HAVE IMPORTANT
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